

HOUSE BILL REPORT

HB 2257

As Reported by House Committee On:

Commerce & Labor

Appropriations

Title: An act relating to requiring state agencies to contract for goods and services in a manner consistent with the state's best interests.

Brief Description: Requiring state contracts to be in the state's best interests.

Sponsors: Representatives Williams, Conway, Morrell and Wood.

Brief History:

Committee Activity:

Commerce & Labor: 3/2/05 [DPS];

Appropriations: 3/5/05 [DP2S(w/o sub CL)].

Brief Summary of Second Substitute Bill

- Requires the Office of Financial Management (OFM) to develop and implement policies to determine whether state contracts are made in the state's best interest, based on whether the contract will be performed outside the United States, the application of international trade agreements, economic impacts in Washington, and possible disclosure of personal information.
- Directs OFM to study the indirect benefits of adopting procurement policies that give Washington businesses a price preference when determining the lowest responsible bidder on a contract.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 4 members: Representatives Conway, Chair; Wood, Vice Chair; Hudgins and McCoy.

Minority Report: Do not pass. Signed by 3 members: Representatives Condotta, Ranking Minority Member; Sump, Assistant Ranking Minority Member; and Crouse.

Staff: Jill Reinmuth (786-7134).

Background:

State Procurement

The State of Washington contracts with individuals and companies outside of state government to provide certain services to the state and its residents. The state's purchasing authority is generally organized into categories based on the type of service. These categories include the following:

- Personal services. This term refers to professional or technical expertise provided by a consultant to accomplish a specific study or project.
- Purchased services. These services are ones provided by a vendor to accomplish routine, continuing and necessary functions.
- Information services. These services include data processing, telecommunications, office automation, and computerized information systems.
- Public works. This term refers to the construction, repair, or alteration of buildings and other real property.
- Highway design and construction. This term includes both architectural and engineering services, as well as construction services related to highways.
- Printing services. This term refers to the production of printed materials.

In addition, beginning July 1, 2005, the state may contract for services historically and traditionally provided by state employees, so long as the state complies with the contracting out provisions of the Civil Service Reform Act of 2002.

Laws governing state procurement that give preference to domestic goods or prohibit purchasing foreign goods have been challenged on one or more grounds. These include arguments that such laws are: (1) invalid exercises of state power under the Foreign Commerce Clause and/or the Foreign Affairs Power; (2) preempted by federal law; or (3) in violation of international agreements on government procurement.

Foreign Commerce Clause

The United States Constitution reserves to Congress the power "to regulate Commerce with foreign Nations, ..." The U. S. Supreme Court has struck down state laws that regulate commerce in a manner that promotes businesses in the state at the expense of businesses in other states or foreign countries. However, the U. S. Supreme Court has also recognized that, when a state acts as a market participant, rather than a market regulator, it is not subject to the restraints of the Commerce Clause. Other federal and state courts, relying on the "market participant doctrine," have generally upheld state "Buy American" laws.

Foreign Affairs Power

With regard to foreign policy, the federal government also has exclusive authority. The U. S. Supreme Court has said that the President has the "lead role" as well as "a degree of independent authority to act." The Court has struck down at least one state law as an "intrusion by the state into the field of foreign affairs which the Constitution entrusts to the President and the Congress."

Federal Preemption

The U.S. Supreme Court has found that state laws in conflict with federal laws or with foreign policies and diplomatic objectives of the President and Congress are preempted.

International Agreements

The Agreement on Government Procurement (GPA) is one of many World Trade Organization (WTO) agreements to which the United States is a party, and is one of several agreements that apply to Washington and certain other states. The GPA is a plurilateral agreement, meaning that only some WTO members are parties to the agreement. For example, Ghana, India, Mexico, and the Philippines are members of the WTO, but are not parties to the GPA.

In Washington, state agencies subject to the GPA include certain executive branch agencies such as the Department of General Administration and the Department of Transportation, as well as state universities. State contracts subject to the GPA currently include contracts of \$477,000 or more for goods and services, and contracts of \$6,725,000 or more for construction services.

Article III of the GPA deals with national treatment and non-discrimination. It provides, in part that:

- Parties to the agreement must give the products, services and suppliers of other parties treatment no less favorable than that accorded to domestic products, services and suppliers.
- Parties must not treat locally-established suppliers less favorably than other suppliers on the basis of foreign affiliation or ownership.
- Parties must not discriminate against locally-established suppliers on the basis of the country of production of the good or service being supplied.

According to the WTO Analytical Index for the GPA, there are no decisions of competent WTO bodies interpreting this article of the GPA. (In 1994 the European Union and Japan filed formal complaints against the United States in the WTO, claiming that Massachusetts' Burma law violated certain provisions of the GPA. In 1999, at the request of the European Union and Japan, these proceedings were suspended. Later, they automatically lapsed.)

Under the federal Uruguay Rounds Agreement Act (Act), Congress approved the WTO agreement and other agreements annexed to that agreement, including the Agreement on Government Procurement. The Act provides that no state law may be declared invalid on the ground that it is inconsistent with any of the Uruguay Round Agreements, except in an action brought by the United States for that purpose. The Act also sets forth procedures for dispute resolutions involving other WTO members and legal actions by the United States against states to declare state laws invalid as inconsistent with any of the Uruguay Round Agreements.

Laws and Executive Orders in Other States

Laws relating to offshore outsourcing of state contracts have been enacted in at least six states (Alabama, Colorado, Illinois, Indiana, North Carolina, and Tennessee). Executive orders or directives relating to offshore outsourcing of state contracts have been issued by the governors of at least six states (Alaska, Michigan, Minnesota, Missouri, New Jersey, and North Carolina). These laws and executive orders and directives address offshore outsourcing of state contracts in various ways, including:

- limiting the authority of state agencies to enter into contracts for services that will be performed at sites outside the United States;
- authorizing state agencies to give price preferences on contracts for services that will be performed within the state;
- encouraging state agencies to enter into contracts for services that will be performed within the state;
- requiring state agencies to consider economic and other impacts of contracts for services that will be performed at sites outside the United States; and
- requiring contractors and subcontractors to disclose information about contracts for services performed at sites outside the United States.

Summary of Substitute Bill:

Certain state contracts, and subcontracts awarded under those contracts, must be in the state's best interests. These contracts include contracts for personal services, purchased services, and goods as well as civil service, public works, corrections, higher education, and transportation contracts.

The Governor, in consultation with representatives of state agency management and labor, must develop and implement procurement policies and procedures necessary to determine whether a particular contract or subcontract is in the state's best interests.

State agencies must consider the following when making decisions to contract for services:

- whether providing goods or services from a location outside Washington or the United States would be detrimental to Washington, its residents, or its economy;
- whether acquiring goods or services from an expatriated business entity located in a tax haven country would be detrimental to Washington, its residents, or its economy;
- whether providing goods or services from a location outside Washington or the United States would be detrimental to privacy interests or would risk disclosure of personal information; and

- whether providing goods or services from a location outside Washington or the United States would constitute undue risk under risk management policies, practices, or procedures.

An "expatriated business entity" is defined as a corporation incorporated in a tax haven country after September 11, 2001, but with the United States as the principal market for the public trading of the corporation's stock. The Director of the Office of Financial Management (OFM) determines whether a corporation is an expatriated business entity.

A "tax haven country" is defined as a country that has no corporate income tax or a tax rate of less than 10 percent on income from another country. The definition specifies that tax haven countries include, but are not limited to: Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, the Bahamas, Cyprus, Gibraltar, the Isle of Man, Liechtenstein, Monaco, and the Seychelles.

This requirement does not apply to contracts entered into by faculty research and study abroad programs authorized by higher education institutions, or by foreign trade officers on behalf of the Department of Agriculture. It also does not apply to contracts entered into prior to July 1, 2005.

This requirement does not apply if the Director of the OFM determines that the only practicable source of the goods or services is clearly and justifiably located outside the United States. Annual reports from the Director of OFM to the House Commerce and Labor Committee and the Senate Labor, Commerce, Research, and Development Committee on such contracts are required.

Washington businesses must be given a price preference of 5 percent when bidding on certain state contracts. These contracts include contracts for personal services, purchased services, and goods as well as civil service, public works, corrections, higher education, and transportation contracts.

The Governor, in consultation with representatives of state agency management and labor, must develop and implement procurement policies and procedures necessary to give Washington businesses the price preference. The policies and procedures must establish a process for determining whether a business is a Washington business, and be consistent with rules designed to provide for reciprocity in bidding between Washington and other states.

"Washington business" is defined as one that: (1) has its principal place of business in Washington; (2) pays a majority of its payroll to Washington residents; (3) employs Washington residents as a majority of its employees; (4) makes significant capital investments in Washington; (5) has a substantial positive economic impact on Washington; or (6) is an employee business unit for purposes of civil service contracts.

Substitute Bill Compared to Original Bill:

Provisions requiring that additional types of contracts be in the state's best interests are added. These types include contracts for goods as well as public works, corrections, higher education, and transportation contracts.

Provisions making the requirement that contracts be in the state's best interests inapplicable in particular circumstances are added. These circumstances are: (1) if the Director of the OFM determines that the only practicable location of the goods or services is clearly and justifiably outside the United States; (2) if the contracts are entered into under faculty research and study abroad programs authorized by higher education institutions; and (3) if the contracts are entered into by foreign trade officers or consultants on behalf of the Department of Agriculture.

Provisions requiring that Washington businesses be given a price preference of 5 percent when bidding on certain state contracts are added.

Appropriation: None.

Fiscal Note: Requested on substitute bill on March 3, 2005.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect immediately, except section 105, relating to civil service contracts, which takes effect July 1, 2005.

Testimony For: (As presented for HB 2144) This bill establishes a four-part test to determine whether contracted services are in the best interests of Washington, its residents, and its economy. It requires the best use of state resources, including an assessment of whether or not a contract will cost jobs or change the quality of life. It is sensible and fair.

Job growth is a priority. Economic security should not be imperiled without carefully considering the consequences. Before creating jobs overseas, the state should consider the impacts at home.

This bill is modeled after an executive order in another state. Other states have already acted, and Washington should be at least as progressive and protective.

Workers have suffered many consequences related to offshore outsourcing. For example, when fabrication jobs were lost on the Narrows Bridge project, it was a blow to the workers and to the state economy.

The bill should be amended to address offshore outsourcing of public works contracts, including fabrication various parts, and to creative incentives for using state-based contractors.

(With concerns for HB 2144) Faculty research and student exchange programs are a concern. It may be that the only practicable location for such programs and related contracts is clearly and justifiably a location outside the United States.

Testimony Against: (As presented for HB 2144) The "best interests" of the state are in the eye of the beholder, especially with regard to taxpayer money. Although the bill is lifted, in part, from an executive order in Michigan, it does not include all parts of the Michigan order. The Michigan order also required disclosure, as well as debarment of vendors that failed to comply. It also specified that the best interests must be determined in a manner consistent with federal and state law. The bill should not slide into a prohibition on offshore outsourcing.

Another concern is the process for developing the procurement policies. Instead of the process outlined in the bill, there should be a process under the Administrative Procedures Act so that the entire community of interest could participate, and the result could be fair and balanced.

Persons Testifying: (In support of HB 2144) Representative Brendan Williams, prime sponsor; Ron Piksa, Iron Workers District Council of the Pacific Northwest; Bev Hermanson and Bob Doyle, Washington Federation of State Employees; and Dave Johnson, Washington State Building & Construction Trades Council.

(With concerns on HB 2144) Gail Stygall, University of Washington Faculty.

(Opposed to HB 2144) Kris Tefft, Association of Washington Business.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Commerce & Labor. Signed by 20 members: Representatives Sommers, Chair; Fromhold, Vice Chair; McDonald, Assistant Ranking Minority Member; Buri, Clements, Cody, Conway, Darneille, Dunshee, Grant, Haigh, Kagi, Kenney, Kessler, Linville, McDermott, Miloscia, Priest, Schual-Berke and Walsh.

Minority Report: Do not pass. Signed by 8 members: Representatives Alexander, Ranking Minority Member; Anderson, Assistant Ranking Minority Member; Armstrong, Bailey, Hinkle, Hunter, Pearson and Talcott.

Staff: David Pringle (786-7310).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Commerce & Labor:

The requirement that certain contracts and subcontracts awarded by the state be in the state's best interest, based on economic, privacy, and risk management considerations are removed. The requirement that Washington businesses be given a price preference of 5 percent over non-Washington bidders on certain contracts is removed, and replaced with the requirement that Office of Financial Management study the indirect benefits of adopting such a price

preference requirement, and report to the Legislature by December 1, 2005. An emergency clause is also deleted.

Appropriation: None.

Fiscal Note: Requested on the substitute bill on March 3, 2005.

Effective Date of Second Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: The bill has been changed from an outright ban on offshoring, and is still a work in progress. State contracts are an investment of public money, and should be used to build the state economy. We can provide examples of how this is the case.

Testimony Against: This removes the low cost value from state contracting. It abandons the open trade policies of the three previous Governors. Only about 1 to 2 percent of state contracts are with overseas entities. We object to the 5 percent price preference provision - it violates our reciprocity agreements with about 30 other states. This adds both process and costs to the state contracting system. Purchasing managers should not have to also serve as economic development directors.

Persons Testifying: (In support) Bob Doyle and Bev Hermanson, Washington Federation of State Employees.

(Opposed) Kris Tefft, Association of Washington Business; and Lew McMurrin, Washington Software Alliance.

Persons Signed In To Testify But Not Testifying: None.